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DE RUEHVI #1619 3081534
ZNR UUUUU ZZH
P 031534Z NOV 08
FM AMEMBASSY VIENNA
TO RUEHC/SECSTATE WASHDC PRIORITY 1275
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
INFO RUCNMEM/EU MEMBER STATES

UNCLAS VIENNA 001619

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E.O. 12958: N/A

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SUBJECT: Kommunalkredit To Be Nationalized; More
Austrian Banks Likely to Take State Capital

REF: (A) VIENNA 1601; (B) VIENNA 1571 and previous

¶1. SUMMARY: The GoA will take over 99.78% of the troubled Austrian bank Kommunalkredit (which provides state/municipal financing) in an 11th-hour move to rescue the bank. Other large Austrian banks and insurance companies appear better off, but rumors are that most will eventually make use of state capital injections. The GoA will charge interest and fees for its equity participation and guarantees, and individual contracts will stipulate additional conditions covering issues such as executive compensation. END SUMMARY.

Kommunalkreditbank To Be Nationalized

¶2. On November 3, the GoA moved to nationalize the troubled Austrian banking group Kommunalkredit. Kommunalkredit's owners -- the Austrian Volksbanken AG and the Belgian-French Dexia Credit Local) -- approved the move. The GoA will take over the 50.78% share of Austrian Volksbanken AG and the 49.0% share of the Belgian-French Dexia Credit Local, paying a symbolic one Euro each to Volksbanken and Dexia. The Austrian Association of Municipalities will keep its 0.22% share in Kommunalkredit. In addition, Volksbanken and Dexia must contribute to Kommunalkredit's rescue by converting some of their unsecured liabilities (EUR 173 million for Volksbanken and EUR 200 million for Dexia) with Kommunalkredit into participation capital. The GoA will provide additional equity to raise Kommunalkredit's equity ratio to 8-9% and provide state guarantees to help Kommunalkredit to acquire credit. Personnel changes in the bank's management are pending.

¶3. The Kommunalkredit rescue was reportedly an emergency operation precipitated by problems in servicing bonds and high money market rates which caused Kommunalkredit's refinancing costs to double in recent months. The bank faced a liquidity crunch with a EUR 1 billion refinancing deal become payable today (November 3) and another EUR 10 billion to be refinanced through December.

More Austrian Banks Likely to Resort to GoA Capital

¶4. Volksbanken, now faced with the complete write-off of its reported EUR 400 million stake in Kommunalkredit, will likely become the next large banking group to resort to GoA rescue funds. After Erste Bank availed itself of a GoA capital injection (reftel), reports are that all large Austrian banks

(including Raiffeisen Zentralbank, BAWAG, Volksbanken, and Hypo Alpe Adria) will make use of available GoA capital and that insurance companies will follow in due course. Bank Austria, Austria's largest banking group and a member of the Italian UniCredit group, would also be eligible for GoA capital, but has not yet shown public interest in taking part.

More Details on the GoA Bank Rescue Package

15. On October 30, the Ministry of Finance (MoF) issued regulations for banks and insurance companies that resort to Austria's EUR 100 billion rescue package. GoA help comes at a price: the GoA will charge interest and fees both for state equity participation and for state guarantees of interbank lending. The MoF ordinance stipulates that institutes resorting to GoA money are obliged to use these funds in part to provide loans to businesses and private individuals, with special emphasis on loans for small and medium-sized enterprises. Each bank or insurance company receiving GoA capital or guarantees will enter an individual contract setting out conditions and terms, potentially with penalties for violating GoA conditions. Still unclear is whether Austrian banks can use state funds to support their extensive subsidiaries in central and southeastern Europe.

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